



Testimony

of

Nicolas Retsinas, Director

Office of Thrift Supervision

concerning

YEAR 2000 COMPUTER COMPLIANCE

before the

Subcommittee on Financial Services and Technology

Committee on Banking, Housing and Urban Affairs

United States Senate

July 30, 1997

Office of Thrift Supervision
Department of the Treasury
1700 G Street N.W.
Washington, D.C. 20552
202-906-6288

**TESTIMONY ON YEAR 2000 COMPUTER COMPLIANCE
BEFORE THE SENATE SUBCOMMITTEE ON
FINANCIAL SERVICES AND TECHNOLOGY**

July 30, 1997

**Nicolas Retsinas, Director
Office of Thrift Supervision**

I. INTRODUCTION

Good morning, Mr. Chairman and members of the Subcommittee. Thank you for the invitation to testify about the Office of Thrift Supervision's (OTS) efforts to address Year 2000 computer compliance. In my testimony today, I will discuss our strategy for examining Year 2000 compliance in the thrift institutions and data servicers that we regulate, and provide the Subcommittee with some preliminary observations gleaned from Year 2000 examinations we have conducted to date. I will also touch upon our efforts to address Year 2000 issues within our internal systems and infrastructure.

As you know, the Year 2000 computer problem has received much attention, not only nationally but globally. At least one source has estimated the global economic impact of the problem to exceed \$600 billion, with \$300 billion of that attributed to the United States. The problem has the potential for disrupting the business of both the public and private sectors. The OTS is aggressively and affirmatively responding to the challenge of ensuring that the computer operations of thrift institutions are in compliance when the calendar rollover occurs less than 30 months from now. This requires the dedication of examination resources, and also involves educating the industry about the Year 2000 problem and its solution. In fact, we have been fostering awareness about Year 2000 problems during our information systems examinations of thrift institutions for some time. We share the Subcommittee's concern about this issue.

II. OTS's YEAR 2000 SUPERVISORY STRATEGY

Mr. Chairman, our testimony today draws on our March 20, 1997, response to your letter of February 27, 1997, that raised several questions about how the OTS is addressing the Year 2000 issue in the financial institutions that we regulate. As described in our response, we have developed a four-part supervisory strategy for addressing Year 2000 compliance to:

1. Enhance industry awareness of the Year 2000 problem;
2. Expand the examination process to include Year 2000 review procedures;
3. Provide active supervision to ensure that necessary system changes are effectuated by year-end 1998 in the institutions we regulate; and,
4. Monitor our overall efforts toward following our plan and fulfilling our responsibilities to protect our insured institutions.

I will briefly review the main features of this strategy.

Industry Awareness

One of our formal, and most visible, efforts to enhance industry awareness about Year 2000 issues began a year ago when the OTS, along with the other financial institution regulators represented on the Federal Financial Institutions Examination Council (FFIEC), sent a statement alerting the industry to computer system risks that may arise from the forthcoming calendar rollover to the next century. In addition to explaining the issues and apparent concerns, the statement provides an action plan and guidelines for financial institutions to follow to ensure that computer systems will function properly and without disruption when the Year 2000 arrives. The statement stresses the need for early, careful planning to alleviate what could become significant problems in the future.

In May 1997, the OTS and the other FFIEC agencies sent a follow-up industry advisory highlighting the need for institutions to make all information processing systems Year 2000 compliant and identifying specific concerns institutions should consider in managing any necessary system conversion process. The statement:

- Outlines the Year 2000 project management process;
- Identifies external risk issues that should be considered as part of a Year 2000 project management plan;
- Discusses operations issues that may be relevant to a Year 2000 planning process;
- Describes the general supervisory approach that will be followed by the FFIEC agencies; and,
- Encloses, for industry awareness and internal use, the FFIEC Year 2000 examination procedures.

The FFIEC also developed and made public on its Internet Web Site a Year 2000 page that contains relevant policy releases and examination procedures, as well as "hot links" to other sites of interest that offer useful Year 2000 materials.

We are also working closely with industry trade groups to ensure that they are aware of our activities. The FFIEC agencies recently held a meeting of several trade groups to distribute information, and to let the trade groups know that agency staff are available to speak at industry gatherings and provide assistance as needed on Year 2000 issues.

In addition to interagency activities, the OTS has been raising the Year 2000 issue with thrift institutions at various industry forums. Most recently, our Northeast Regional

office arranged a symposium, held on May 30, 1997, to help financial institutions understand Year 2000 issues. The symposium attracted 123 representatives from thrift institutions and 29 service bureaus. Speakers included representatives from the private sector, the Administration, the Congress and the OTS. The value of this kind of exchange cannot be over-emphasized. We are currently exploring the idea of conducting similar conferences in co-sponsorship with the primary thrift trade group.

Moreover, for the past several years, the OTS has included the Year 2000 issue within the scope of routine information systems examinations of thrift institutions and the companies that provide data services to them. We have made Year 2000 compliance an integral part of these examinations.

OTS will soon be adding to its Internet Web Site a computer application that helps institution management monitor progress toward completing a Year 2000 conversion and renovation project. This tool is a spreadsheet-based checklist that guides management through the assessment, planning and implementation phases of a computer modification project so that systems will continue to operate correctly into the new millennium.

These activities enhance awareness of the issues, as well as promote a better understanding of steps needed to ensure proper identification and correction of potential computer problems.

Year 2000 Examination Process

The second component of our plan involves expanding our examination process to include procedures pertaining to Year 2000 issues. OTS is conducting off-site supplemental examinations of all thrift institutions and is using specially-designed procedures. The purpose is to assess each thrift institution's awareness of, and planning for, the impact the Year 2000 calendar rollover may have on information processing systems, and to identify the risks that the rollover may pose for individual institutions and

the industry as a whole. Key data from these examinations will be entered into a special database established to help us monitor institutions' progress toward completing necessary system changes.

As of May 30, 1997, our regional offices sent Year 2000 off-site examination procedures and guidelines to each thrift institution, asking for a response by September 30, 1997. These procedures are included as Exhibit A to this testimony. The responses to these examination procedures will help us evaluate the degree to which thrift institutions are aware of the potential for Year 2000 rollover problems. The answers will tell us whether institutions have properly analyzed the potential impact this rollover will have on their computer systems, as well as if they have taken appropriate corrective actions.

We are also including Year 2000 examination steps in our regular examinations of thrift institutions, and will conduct, as necessary, supplemental reviews of conversion/renovation efforts in those institutions that pose risks. The combination of this off-site approach and routine examinations that address Year 2000 compliance will help ensure that institutions are properly addressing this serious issue.

In conducting examinations, we have marshaled our resources to maintain high quality, while retaining our ability to properly supervise the industry. Generally, we are using our safety and soundness examination force to conduct the off-site and regular examinations of thrift institutions. We are using our Information Systems (IS) examiners to focus on service bureaus and shared application software systems. Regional management is coordinating the efforts of these examination disciplines to avoid duplication of work in cases involving examination of in-house computer systems.

Regional management may also involve IS examiners directly in Year 2000 examinations of institutions with large or complex data processing environments.

In addition to conducting these initial examinations of Year 2000 awareness and planning, we will review each thrift's actual Year 2000 renovation and conversion efforts by mid-1998. Appropriate follow-up attention will be given to those that have not completed their Year 2000 conversion by that time. We have encouraged our regional offices to use the full range of examination approaches available to them to ensure the completion of these examinations by deploying on-site, off-site, special and limited examinations, and field visitations, as necessary based on the circumstances found at each thrift institution. Clearly, some institutions will need more attention than others. For example, we are particularly aware of the potential burden of Year 2000 compliance on our smaller institutions. This strategy will assure that we use our limited resources in an efficient manner while continuing to devote proper attention to our other statutory and regulatory mandates.

Although the ultimate responsibility for Year 2000 compliance rests with the thrift institutions themselves, many of them rely on the services of outside companies and vendors for their data processing operations. Consequently, our IS examiners, as well as those from the other banking agencies, are also conducting Year 2000 examinations of these entities. We intend to complete assessments of these entities by September 30, 1997, and to conduct examinations of all data servicers by mid-1998.

Not only are we looking at thrifts and their service providers, but we are also looking at each institution's entire environment. OTS examiners will review whether thrifts are properly evaluating Year 2000 renovation and conversion efforts among their service corporations, operating subsidiaries, holding companies and other affiliates. Further, our examiners have been instructed to determine if institutions are monitoring counter party risk and credit risk as they relate to Year 2000 preparedness.

Active Supervision

The third element of our comprehensive strategy involves the active supervision of thrift institutions and data servicers to ensure that Year 2000 compliance is attained. We are using the results of our off-site examinations, which will be completed by early Fall 1997, to prioritize future on-site examinations through mid-1998 and to help us evaluate the overall industry risk exposure.

Consistent with this element of our efforts, we will also be looking at Year 2000 issues as part of the corporate applications we process to ensure that any corporate acquisition will not have adverse effects on an applicant. For example, applicants will be asked to provide specific information on the strategies they have developed to address Year 2000 problems. If necessary, application approval will be conditioned upon favorable results from the OTS Year 2000 examination program.

Monitoring

We have taken several steps to ensure our efforts are coordinated and we stay on schedule. First, we appointed one of our highest level examiners as our National Year 2000 Coordinator. This individual is charged with ensuring that appropriate attention is directed to all OTS-regulated thrift institutions, including adequate monitoring of progress and follow-up to address identified problems. She will generally work with quality assurance staff and management in our regional offices to review agency efforts to ensure industry-wide compliance. Second, we have instructed our regional management to involve our quality assurance staff to assist with monitoring at the local level. Third, we developed an internal survey system—which utilizes examination results to assist us in compiling management information output reports—that will enable us to pinpoint progress at each thrift institution as individual Year 2000 plans are implemented.

III. PRELIMINARY OBSERVATIONS FROM YEAR 2000 EXAMINATIONS

OTS will prepare a general assessment of the thrift industry's preparedness for the Year 2000 rollover after the completion of our off-site examination program. As indicated in our March 20 response to the Subcommittee, we will have that assessment available by year-end 1997. At that time, we will have a clear picture of industry progress toward addressing the Year 2000 issue. In the interim, however, we do have some preliminary results from the off-site examinations that have been completed to date.

We have received responses to our off-site examinations from 75 of the thrift institutions we regulate. The asset sizes of the respondents range from \$3 million to \$4.5 billion. It is important to frame the following observations and consider that about 80 percent of the thrift institutions we regulate rely on service bureaus for their data processing needs. However, these 80 percent hold only about 27 percent of total thrift assets. The remaining 20 percent, holding about 73 percent of industry assets, primarily rely on in-house or turnkey systems. The observations that we can make so far are:

- In general, thrifts have a good sense of awareness of the Year 2000 problem, and thrift management is actively involved in addressing the scope of the potential issues, developing strategies and remedial plans. This holds true for smaller as well as larger institutions. Most thrifts have appointed an officer or committee to spearhead their Year 2000 efforts.
- Although awareness levels are typically high, some of the responses suggest that thrift management may not be fully attuned to the critical time sensitivities associated with this issue, particularly where processing is performed by service bureaus. This indicates the need for further follow-up with the industry in the form of additional guidance and enhanced supervision, and we will respond accordingly.

- Thrift institutions that rely on outside servicers have been contacting the servicers to discuss plans for addressing Year 2000 issues and problems that could occur. Some thrifts report that servicers are demonstrating a commitment to work with the industry toward the timely resolution of issues.
- In addition to the responses received to date, we contacted a few other institutions to gather cost data. Data on direct costs for Year 2000 campaigns cover an extremely wide range with little correlation to asset size, or whether processing is performed internally or by outside firms. For example, a \$61 million thrift with outside servicing provided us with a \$75,000 estimate. Further, a \$10 billion dollar thrift that operates in a service bureau environment provided us with an estimate of \$300,000 to oversee the compliance efforts of its vendors. By contrast, a \$5 billion thrift with in-house systems placed a \$3 million price tag on its efforts and another \$3 billion thrift that runs an in-house system with vendor-supplied software estimated a \$200,000 cost for vendor oversight.

IV. OTS's INTERNAL YEAR 2000 PROGRESS

In addition to monitoring industry efforts to address Year 2000 problems, the OTS is actively addressing its own concerns related to its own internal systems and infrastructure. In 1996, we completed an assessment of our national systems and developed a conversion plan, which received necessary agency budget approval. To date, we have completed approximately 40 percent of the computer code modifications necessary for Year 2000 compliance. Another 50 percent of computer code revisions are currently underway, with modifications to the remaining 10 percent to begin shortly. All modifications are expected to be completed during 1998. We will begin validation testing of converted systems in September 1997, and will conduct further intensive testing during 1998 and 1999.

Washington and regional OTS staff are also actively reviewing infrastructure and building support software and hardware. Approximately 95 percent of our Washington building systems, including elevators, heating and air conditioning controls, emergency systems, and electrical distribution systems have been determined to be Year 2000 compliant. Programs and software obtained from external vendors and contractors are being inventoried for compliance purposes, and all new procurement contracts contain Year 2000 compliance requirements. The OTS also now complies with Treasury Year 2000 requirements for status reporting and cost modeling. OTS Senior staff and management actively support the various Year 2000 projects and are briefed periodically on their progress.

V. CONCLUSION

Mr. Chairman, the OTS takes this issue seriously. The combination of enhancing industry awareness, conducting off-site and on-site examinations, actively supervising the industry and monitoring our own compliance efforts should ensure that effective and timely actions are taken to avoid problems when the calendar rolls over to the Year 2000.